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No. 94-967

In the Supreme Court of the United States

OCTOBER TERM, 1994

WILLIAM FIELD AND NORRINE FIELD, PETITIONERS

v.

PHILIP W. MANS

ON WRIT OF CERTIORARI
TO THE UNITED STATES COURT OF APPEALS
FOR THE FIRST CIRCUIT

BRIEF FOR THE UNITED STATES AS AMICUS CURIAE SUPPORTING PETITIONERS

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QUESTION PRESENTED

Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A), does not permit a debtor to discharge a debt incurred by "false pretenses, a false representation, or actual fraud." The question presented is whether creditors who rely on a fraudulent misrepresentation and who invoke Section 523(a)(2)(A) to resist the discharge of a debt must also prove that their reliance on the debtor's misrepresentation was reasonable.

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INTEREST OF THE UNITED STATES

This case concerns the showing that a defrauded creditor must make, pursuant to 11 U.S.C. 523(a)(2)(A), in order to prevent the discharge in bankruptcy of a debt incurred by fraud. That question is of interest to the United States because agencies of the federal government frequently oppose the discharge of debts under Section 523(a)(2)(A).[1] The United States also has an interest in

[1] See, *e.g.*, *In re Foust*, 52 F.3d 766 (8th Cir. 1995); *In re Daily*, 47 F. 3d 365 (9th Cir. 1995); *In re Turner*, 179 B.R. 273 (Bankr. D. Colo. 1995); *In re Calhoun*, 131 B.R. 757 (Bankr. D.D.C. 1991); *In re Davis*, 116

opposing a rule that imposes an additional, unwarranted burden on victims of fraud.

The United States often obtains money judgments under federal anti-fraud statutes, such as the False Claims Act, 31 U.S.C. 3729-3731 (1988 & Supp. V 1993), against individuals who subsequently file for bankruptcy. The rule adopted by the court of appeals in this case that, in order to prevent the discharge of a fraudulently incurred obligation a creditor must prove that its reliance on the debtor's misrepresentation was reasonable, may impair the government's ability to collect such judgments and, therefore, its ability fully to enforce civil anti-fraud statutes.

In addition, the government frequently participates in bankruptcy proceedings as a receiver for a defrauded creditor, or as guarantor or insurer of a defrauding debtor's obligation.[2] Where the government pursues a claim in bankruptcy that it acquired as a receiver or assignee of the original creditor, its distance from the facts surrounding the fraudulent transaction, and the need to utilize witnesses with interests adverse to the government, will often make the requirement of proving reasonable reliance particularly onerous.

B.R. 306 (Bankr. M.D. Ga. 1990); *United States* v. *Singleton*, 91 B.R. 604 (Bankr. N.D. Fla. 1988).

[2] See, *e.g.*, 12 U.S.C. 1821(d)(2)(A)(i) (Supp. V 1993) (granting Federal Deposit Insurance Corporation, as receiver, all legal "rights, titles, powers, and privileges" of closed national and district banks); 12 U.S.C. 1709(b) (1988 & Supp. V 1993), 1710(a) (Supp. V 1993) (providing, respectively, for insurance of mortgages by, and assignment of mortgagee's claims to, Department of Housing and Urban Development under National Housing Act).

STATEMENT

Petitioners sold real estate to respondent for $275,000 in cash and a second mortgage note for $187,500. Pet. App. 24. The second mortgage contained a due-on-sale clause, under which the entire remaining obligation would become immediately payable if respondent conveyed the property without petitioners' consent. *Ibid.* On October 8, 1987, respondent triggered the due-on-sale clause by transferring the property to a newly formed partnership, Crescent Beach Development, without petitioners' knowledge. *Ibid.* On October 9, 1987, respondent wrote to petitioners asking them to waive the due-on-sale clause, but did not inform them that he had already transferred the property. *Ibid.* In response, petitioners informed respondent that they would waive the due-on-sale clause in return for $250 for lost interest due from the previous closing, $250 for attorney's fees, and an additional fee of $10,000. *Ibid.* On October 27, 1987, respondent made a counter offer, agreeing to the two $250 payments, but rejecting the requested $10,000 fee. In advancing his counter offer, respondent again failed to inform petitioners that he had already transferred the property. *Id.* at 25. Petitioners did not respond to respondent's counter offer, and no further correspondence occurred between the parties for over three years. *Ibid.*

On December 10, 1990, respondent filed a petition in the United States Bankruptcy Court for the District of New Hampshire seeking relief under Chapter 11 of the Bankruptcy Code.[3] Petitioners did not learn of the October

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[3] Chapter 11 provides for the reorganization of business enterprises. Respondent's bankruptcy proceeding was subsequently converted to one for liquidation under Chapter 7 of the Code. Letter from respondent to Francis J. Lorson, Chief Deputy Clerk (Jan. 30, 1995). That conversion

8, 1987, property transfer until February 6, 1991, when their attorney informed them that he had researched the deed to the property and discovered the transfer. Pet. App. 25. Petitioners then filed a complaint in the bankruptcy proceeding, asserting that approximately $150,000 of respondent's second mortgage debt should be exempted from discharge pursuant to Section 523(a)(2)(A) of the Bankruptcy Code, 11 U.S.C. 523(a)(2)(A), as a debt incurred through fraud. Pet. App. 23.[4]

The bankruptcy court held that the debt was dischargeable. The court agreed with petitioners that respondent's letters requesting a waiver of the due-on-sale

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should have no effect on the issues before this Court. Cf. *Toibb* v. *Radloff*, 501 U.S. 157, 160-166 (1991) (discussing the scope of Chapters 7 and 11).

[4] Section 523 provides, in pertinent part:

> (a) A discharge under section 727, 1141, 1228(a), 1228(b), or 1328(b) of this title does not discharge an individual debtor from any debt —
>
> * * * * *
>
> (2) for money, property, services, or an extension, renewal, or refinancing of credit, to the extent obtained by —
>
> (A) false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition;
>
> (B) use of a statement in writing —
>
> (i) that is materially false;
>
> (ii) respecting the debtor's or an insider's financial condition;
>
> (iii) on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied; and
>
> (iv) that the debtor caused to be made or published with intent to deceive[.]
>
> * * * * *

clause without disclosing the property transfer were false representations, and that petitioners relied on those representations to their detriment by continuing to extend respondent credit when they could have demanded full payment as of October, 1987. Pet. App. 25. The court concluded, however, that petitioners' reliance was unreasonable under the circumstances, and that the debt was, therefore, ineligible for exception from discharge under Section 523(a)(2)(A). Pet. App. 25.

The district court affirmed. Pet. App. 22-31. It held that the question whether a creditor must prove that he reasonably relied on a debtor's misrepresentation in order to prevent a discharge pursuant to Section 523(a)(2)(A) was settled in the affirmative by the First Circuit's decision in *In re Burgess*, 955 F.2d 134 (1992). Pet. App. 28-29. After reviewing the transcript of the relevant bankruptcy court hearing, the district court concluded that the record supported the bankruptcy court's finding that petitioners' reliance on respondent's misrepresentation was not reasonable. In the district court's view, information available to petitioners should have prompted them to investigate the property's ownership. *Id.* at 30. The district court subsequently denied petitioners' motion for reconsideration under Federal Rule of Civil Procedure 60(b). Pet. App. 17-21. The court of appeals affirmed in a brief, unpublished opinion, relying on its decision in *In re Burgess*. *Id.* at 14-16.

SUMMARY OF ARGUMENT

A. Introduction of a requirement of proof of reasonable reliance in cases arising under Section 523(a)(2)(A) is contrary to the language and structure of the Bankruptcy Code. While Congress expressly required a showing of reasonable reliance to prevent discharge induced by a false written statement "respecting the debtor's or an insider's

financial condition" under Section 523(a)(2)(B), no similar requirement appears in the text of Section 523(a)(2)(A). Judicial importation of a reasonable reliance requirement in cases arising under Section 523(a)(2)(A) would remove an essential and explicit difference between the two provisions. Such a construction would also render the requirement of reasonable reliance in subparagraph (B) cases superfluous, in contravention of the well-established principle that courts should "avoid a reading which renders some words altogether redundant." *Gustafson* v. *Alloyd Co.*, 115 S. Ct. 1061, 1069 (1995).

B. The legislative history of Section 523(a)(2) confirms that Congress intended to confine the requirement of proof of reasonable reliance to subparagraph (B). When Congress reexamined the old Bankruptcy Act in 1978, it divided former Section 17(a)(2) of the Act into subparagraphs 523(a)(2)(A) and 523(a)(2)(B) of the new Code. That division, and the introduction of a requirement of proof of reasonable reliance in subparagraph (B), was intended to address a problem of creditor abuse that had arisen with respect to fraud claims based on technically incomplete written financial statements submitted by borrowers to finance companies. H.R. Rep. No. 595, 95th Cong., 1st Sess. 130-131 (1977). Congress did not include a proof of reasonable reliance requirement in subparagraph (A) because the problem it sought to address did not extend to the general fraud cases covered by that provision. *In re Ophaug*, 827 F.2d 340, 343 (8th Cir. 1987); 124 Cong. Rec. 32,399 (1978) (statement of Rep. Edwards) ("Subparagraph (A) is mutually exclusive from subparagraph (B). Subparagraph (B) pertains to the so-called false financial statement."). Judicial creation of an additional required element of proof in Section 523(a)(2)(A) cases would undermine Congress's policy judgment that victims of fraud should generally be

protected against discharge without having to prove that their reliance on a fraudulent statement was reasonable.

C. The introduction of a reasonable reliance requirement into Section 523(a)(2)(A) would also be contrary to the policy judgments that underlie the Code. The Code's "fresh start" principle is intended to shield the "honest but unfortunate" debtor from the crushing burden of pre-existing debt. *Brown* v. *Felsen*, 442 U.S. 127, 128 (1979). Where, as here, Congress has exempted from discharge debts incurred through debtor fraud, that principle does not apply.

D. Finally, the court of appeals' ruling on this question of federal statutory construction cannot be justified by common law principles of fraud. The textual and historical indicia of congressional purpose discussed above make resort to the common law inappropriate.

ARGUMENT

SECTION 523(a)(2)(A) OF THE BANKRUPTCY CODE DOES NOT REQUIRE A DEFRAUDED CREDITOR TO PROVE "REASONABLE RELIANCE" IN ORDER TO PREVENT THE DISCHARGE OF A FRAUDULENTLY INCURRED DEBT

The court of appeals in this case held that creditors like petitioners, who rely in good faith on the fraudulent misrepresentations of dishonest debtors, may not recover debts so incurred unless they can also demonstrate that their reliance was "reasonable in the circumstances." Pet. App. 16 (quoting *In re Burgess*, 955 F.2d 134, 140 (1st Cir. 1992)). That holding is incorrect. The language, structure, and legislative history of Section 523(a)(2), and the equitable principles that underlie the Bankruptcy Code, indicate that a defrauded debtor in petitioners' position is not required to prove that its reliance on the fraudulent

misrepresentation was reasonable as well as that it was in good faith.

A. The Language And Structure Of The Bankruptcy Code Demonstrate That Proof Of Reasonable Reliance Is Not An Element Of A Defrauded Creditor's Burden In Disputes Arising Under Section 523(a)(2)(A)

Section 523(a)(2) exempts two categories of fraudulently incurred obligations from discharge in bankruptcy. Subparagraph (A), at issue here, exempts debts obtained by "false pretenses, a false representation, or actual fraud, other than a statement respecting the debtor's or an insider's financial condition," and contains no further qualification. 11 U.S.C. 523(a)(2)(A). Subparagraph (B), in contrast, exempts debts obtained by "use of a statement in writing * * * (i) that is materially false; (ii) respecting the debtor's or an insider's financial condition; (iii) *on which the creditor to whom the debtor is liable for such money, property, services, or credit reasonably relied*; and (iv) that the debtor caused to be made or published with intent to deceive." 11 U.S.C. 523(a)(2)(B) (emphasis added). Thus, while subparagraph (B) expressly requires that a creditor prove that its reliance on the fraudulent statement was "reasonable," subparagraph (A) contains no such requirement.

The language of these two provisions clearly limits application of the reasonable reliance requirement to cases arising under subparagraph (B). See *Patterson* v. *Shumate*, 504 U.S. 753, 758 (1992) (comparing parallel provisions of Bankruptcy Code to determine meaning of statutory language); *Toibb* v. *Radloff*, 501 U.S. 157, 161 (1991) (same). The text of Section 523(a)(2)(B)(iii) demonstrates that Congress well knew how to require proof of reasonable reliance when that was its intent. It chose to do so, however, only as to the category of written statements

misrepresenting a debtor's or an insider's financial condition. See *In re Mayer*, 51 F.3d 670, 675 (7th Cir. 1995) ("Congress deliberately distinguished the criteria for discharge according to the kind of document in which the falsehood appears."). Short of affirmatively prohibiting consideration of the reasonableness of reliance under subparagraph (A), we can think of no way in which Congress could more clearly have limited the application of that requirement to the financial statement category of cases.

By requiring an element of proof under subparagraph (A) that is not required by the statutory text, the court of appeals also ignored the principle that, "[i]n construing a statute [courts] are obliged to give effect, if possible, to every word Congress used." *Reiter* v. *Sonotone Corp.*, 442 U.S. 330, 339 (1979). See also *United States* v. *Menasche*, 348 U.S. 528, 538-539 (1955); 2A N. Singer, *Sutherland Statutory Construction* § 46.06, at 119 (rev. 5th ed. 1992). If the court of appeals' construction were correct, the express inclusion of a reasonable reliance requirement in Section 523(a)(2)(B)(iii) would be rendered superfluous.[5]

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[5] As the Seventh Circuit pointed out in *In re Mayer*, 51 F.3d 670, 674-675 (1995), subparagraph (B) also contains an express requirement of proof of a debtor's "intent to deceive" that does not appear in subparagraph (A). Subparagraph (A), however, contains the phrase "actual fraud." The legislative history of Section 523(a)(2) indicates that Congress intended to require proof of scienter under both subparagraphs. It did so in subparagraph (B) by including the term "intent to deceive," and in subparagraph (A) by including the term "actual fraud." See 124 Cong. Rec. 33,998 (1978) (comments of Sen. DeConcini) ("Subparagraph (A) is intended to codify current case law *e.g.*, *Neal* v. *Clark*, 95 U.S. 704 (1887) [*sic*], which interprets 'fraud' to mean actual or positive fraud rather than fraud implied in law.").

Unlike the situation with regard to the requirement of proof of reasonable reliance, the courts had long required proof of scienter under

B. Introduction Of A Proof of Reasonable Reliance Requirement Into Section 523(a)(2)(A) Would Be Contrary To The Legislative History Of The 1978 Bankruptcy Code

The legislative history of Section 523(a)(2) confirms that Congress did not intend to require proof of the reasonableness of reliance under subparagraph (A). Section 523(a)(2) is derived from Section 17(a)(2) of the Bankruptcy Act of 1898, former 11 U.S.C. 35(a)(2) (1976), which excepted from discharge debts that

> are liabilities for obtaining money or property by false pretenses or false representations, or for obtaining money or property on credit or obtaining an extension or renewal of credit in reliance upon a materially false statement in writing respecting his financial condition made or published or caused to be made or published in any manner whatsoever with intent to deceive.

When Congress adopted the 1978 Bankruptcy Code, it divided Section 17(a)(2) into two independent components, subparagraphs 523(a)(2)(A) and (B). As discussed above, subparagraph (A) addresses the general category of debts arising from fraudulent conduct "other than a statement respecting the debtor's or an insider's financial condition," 11 U.S.C. 523(a)(2)(A), while subparagraph (B) applies only to materially false, written statements of a debtor's, or insider's financial condition "on which the creditor to

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the predecessors to Section 523(a)(2)(A) and (B). See *Neal* v. *Clark*, 95 U.S. 704, 709 (1877) (construing Bankruptcy Act of 1867); *Carini* v. *Matera*, 592 F.2d 378, 381 (7th Cir. 1979) (construing Section 17(a)(2) of 1898 Act); *In re Houtman*, 568 F.2d 651, 655-656 (9th Cir. 1978) (same). Since the revision of the Code, the courts of appeals have uniformly required proof of scienter under subparagraph 523(a)(2)(A), see *In re Mayer*, 51 F.3d 670, 675 (7th Cir. 1995) (listing cases), and that question is not at issue in this case.

whom the debtor is liable * * * reasonably relied," 11 U.S.C. 523(a)(2)(B)(iii).

By introducing a proof of reasonable reliance requirement only as to the latter class of debts, Congress sought to address a specific problem. After extensive hearings,[6] Congress determined that the false financial statement language of Section 17(a)(2) of the Act had been frequently abused by consumer finance companies in a manner that frustrated the purposes of the Act. The House Report on the 1978 Code[7] describes the problem:

> It is a frequent practice for consumer finance companies to take a list from each loan applicant of other loans or debts that the applicant has outstanding. While the consumer finance companies use these statements in evaluating the credit risk, very often the statements are used as a basis for a false financial statement exception to discharge. The forms that the applicant fills out often have too little space for a

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[6] See H.R. Rep. No. 595, 95th Cong., 1st Sess. 2 & n.6 (1977) (discussing hearings before Subcommittee on Civil and Constitutional Rights of the House Committee on the Judiciary); S. Rep. No. 989, 95th Cong., 2d Sess. 2 (1978) [hereinafter Senate Report] (discussing hearings before the Subcommittee on Improvements in Judicial Machinery of the Senate Committee on the Judiciary).

[7] In cases in which the text of a statute fails to provide clear guidance, this Court "ha[s] repeatedly stated that the authoritative source for finding the Legislature's intent lies in the Committee Reports on the bill, which 'represen[t] the considered and collective understanding of those [members of Congress] involved in drafting and studying proposed legislation.' " *Garcia* v. *United States*, 469 U.S. 70, 76 (1984) (quoting *Zuber* v. *Allen*, 396 U.S. 168, 186 (1969)). See also *Thornburg* v. *Gingles*, 478 U.S. 30, 43 n.7 (1986). Here, the Senate and House reports strongly reinforce the plain meaning of the statute's text. See *Kelly* v. *Robinson*, 479 U.S. 36, 50-51 (1986) (construing Section 523(a)(7) in light of House and Senate reports on the 1978 Code).

complete list of debts. Frequently, a loan applicant is instructed by a loan officer to list only a few or only the most important of his debts. Then, at the bottom of the form, the phrase "I have no other debts" is either printed on the form, or the applicant is instructed to write the phrase in his own handwriting. In addition, the form states that the creditor has relied on the statement in granting the loan.

H.R. Rep. No. 595, 95th Cong., 1st Sess. 130 (1977) (footnote omitted) [hereinafter House Report]. The House Report further states that, although finance companies generally have available other methods of verifying the accuracy of a debtor's statement, these creditors had successfully used debtors' "deficient" statements to prevent the discharge of their underlying obligations when the debtors later filed for bankruptcy. *Id.* at 131.

The addition of a requirement that reasonable reliance be proved for obligations arising from false statements of financial condition was a direct congressional response to this practice. Based on the conclusion that "current law * * * requires only reliance, not reasonable reliance, by the creditor on the statement," House Report 130,[8] the House

[8] The House Report notes that "[t]he courts have recently begun to require that the reliance be reasonable," House Report 130, and elsewhere describes the addition of a reasonableness requirement as one that "codifies case law construing [Section 17(a)(2)]," *id.* at 364. In fact, there was considerable disagreement among the lower courts on this issue at the time of the Code's enactment. Compare *In re Arden*, 75 B.R. 707, 711 (Bankr. D.R.I. 1975) (inferring reasonableness requirement under Section 17(a)(2)) and *Sweet* v. *Ritter Finance Co.*, 263 F. Supp. 540, 542-543 (W.D. Va. 1967) (same) with *In re Houtman*, 568 F.2d at 655 (requiring only reliance) and *In re McGrath*, 7 B.R. 496, 498 (S.D.N.Y. 1980) (same); see also *In re Garman*, 643 F.2d 1252, 1256 (7th Cir. 1980) (interpreting pre-Code decisions employing the word "reasonable" as requiring only actual reliance). In any event, Congress clearly concluded that any judicial trend toward a proof of reasonable reliance requirement in financial statement cases was not so well-established as to obviate the need for express inclusion of the requirement in Section 523(a)(2)(B) of the new Code.

bill, and ultimately the final legislation,[9] included a proof of reasonable reliance requirement in the newly enacted Section 523(a)(2)(B) in order to prevent commercial finance creditors from taking unfair advantage of consumers seeking loans. House Report 130.

The false financial statement provision attracted considerable attention in the legislative process that proceeded the adoption of the Code. Citing the familiar problem of misuse by finance companies, the Commission on the Bankruptcy Laws of the United States[10] recommended that the false financial statement exemption be eliminated entirely for consumer debts. See H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. 1, at 176 (1973) ("On balance, the abuses and the harmful effects [of the false financial statement provision] far outweigh the benefit to creditors by this exception."). Other commentators, including the National Conference of Bankruptcy Judges, opposed the elimination of the false financial statement exemption, contending that such a change would unnecessarily "legislat[e] out of existence various substantive legal rights" of creditors. *The Bankruptcy Reform Act: Hearings Before the Subcomm. on Improvements in*

[9] The final House bill, H.R. 8200, 95th Cong., 2d Sess., was adopted by the Senate, in lieu of the parallel Senate version, S. 2266, 95th Cong., 2d Sess. 124 Cong. Rec. 28,284 (1978).

[10] Congress created the Commission on the Bankruptcy Laws of the United States in 1970 to "study, analyze, evaluate, and recommend changes to the [Bankruptcy] Act." S.J. Res. 88, 91st Cong., 2d Sess. § 1(b), 84 Stat. 468 (1970). The Commission filed its final report with Congress in July, 1973. H.R. Doc. No. 137, 93d Cong., 1st Sess. Pt. 1 (1973).

Judicial Machinery of the Senate Comm. on the Judiciary, 94th Cong., 1st Sess. Pt. 1, at 62 (1975). See also *id.* at 187, 202, 207. Ultimately, Congress struck a balance between these competing concerns by retaining the false financial statement exception but limiting its reach by the addition of a requirement of proof of reasonable reliance on the false financial statement. See, *e.g.*, House Report 131 (The 1978 Code "retains the exception, with small modifications. But it also recognizes that the leverage creditors have over their debtors comes not so much at the stage when the loan application is made, but rather when bankruptcy ensues."). Section 523(a)(2)(B) is the product of that compromise.[11]

As the legislative background described above demonstrates, Congress's separate treatment of the false financial statement provision was quite deliberate. See, *e.g.*, 124 Cong. Rec. 33,998 (1978) (statement of Sen.

[11] The division and alteration of Section 17(a)(2) of the old Act into Section 523(a)(2)(A) and (B) of the Code was one of several changes aimed at addressing creditor abuse of the "false financial statement" provision. At the same time, Congress also created Section 523(d) of the Code, which provides:

> If a creditor requests a determination of dischargeability of a consumer debt under subsection (a)(2) of this section, and such debt is discharged, the court shall grant judgment in favor of the debtor for the costs of, and a reasonable attorney's fee for, the proceeding if the court finds that the position of the creditor was not substantially justified, except that the court shall not award such costs and fees if special circumstances would make the award unjust.

11 U.S.C. 523(d). The House Report explains that "[t]he purpose of the provision is to discourage creditors from initiating false financial statement exception to discharge actions in the hopes of obtaining a settlement from an honest debtor anxious to save attorney's fees. Such practices impair the debtor's fresh start." House Report 365. See also Senate Report 80 (using substantially similar language).

DeConcini) ("Subparagraph (A) is mutually exclusive from subparagraph (B). Subparagraph (B) pertains to the so-called false financial statement."). Indeed, if Congress had intended the reasonable reliance requirement to be applied to all debts arising from fraudulent conduct, there would have been no need to subdivide Section 17(a)(2) of the Act into subparagraphs 523(a)(2)(A) and (B); the more logical course would have been simply to include the reasonable reliance language in a unified Section 523(a)(2). By giving the same meaning to two provisions so carefully distinguished during the legislative process, the interpretation adopted by the court of appeals ignores the balance intentionally and explicitly struck by Congress.

C. Introduction Of A Reasonable Reliance Requirement Into Section 523(a)(2)(A) Would Contravene The Policy Judgments That Underlie The Bankruptcy Code

The courts that have required proof of reasonable reliance have primarily relied on the Code's general goal of providing debtors a "fresh start," concluding that that goal outweighs the interests of creditors who cannot prove that they acted reasonably. See, *e.g.*, *In re Phillips*, 804 F.2d 930, 932 (6th Cir. 1986); *In re Newmark*, 20 B.R. 842, 861-862 (Bankr. E.D.N.Y. 1982); *In re Brewood*, 15 B.R. 211, 215 (Bankr. D. Kan. 1981); cf. *In re Burgess*, 955 F.2d at 137 ("the statutory requirements for a discharge in bankruptcy are construed liberally in favor of the debtor") (internal quotation marks omitted). As this Court has instructed, however, the bankruptcy laws' "fresh start" principle "provides little assistance in construing a section expressly designed to make some debts non-dischargeable." *United States* v. *Sotelo*, 436 U.S. 268, 280 (1978) (construing Section 17(a)(1) of the Bankruptcy Act). The statutory language and legislative history discussed above demonstrate that Congress placed the interests of fraud victims above those

of dishonest debtors in the treatment of claims arising under Section 523(a)(2)(A).

"There is an overriding consideration that equitable principles govern the exercise of bankruptcy jurisdiction." *Kelly* v. *Robinson*, 479 U.S. 36, 49 (1986) (quoting *Bank of Marin* v. *England*, 385 U.S. 99, 103 (1966)). Accordingly, this Court has frequently indicated that the Code's "fresh start" principle has far less importance when the obligation at issue arises from a debtor's dishonest conduct. See, *e.g.*, *Kelly* v. *Robinson*, *supra* (finding restitution, as a criminal penalty for welfare fraud, to be non-dischargeable under Section 523(a)(7)); *Grogan* v. *Garner*, 498 U.S. 279 (1991) (rejecting application of "clear and convincing evidence" standard in claims arising under Section 523(a)(2)); *Brown* v. *Felsen*, 442 U.S. 127 (1979) (res judicata did not bar creditor from demonstrating fraudulent conduct under Section 17(a)(2) in order to prevent discharge of a prior settlement agreement).

In *Grogan*, the Court considered the standard of proof that should be applied to objections to discharge brought under Section 523(a)(2). The court of appeals in that case had required that creditors prove their claims of fraud under Section 523(a)(2) by clear and convincing evidence. 498 U.S. at 282. There, as in the instant case, the court of appeals based its decision in part on its conclusion "that the general 'fresh start' policy that undergirds the Bankruptcy Code militated in favor of a broad construction favorable to the debtor." *Id.* at 283. This Court reversed, holding that a "preponderance of the evidence" standard best accommodated the interests at issue in claims brought under Section 523(a)(2). While acknowledging the Code's general policy of affording debtors a "fresh start," the Court recognized that

> [t]he statutory provisions governing nondischargeability reflect a congressional decision to exclude from the general policy of discharge certain categories of debts—such as child support, alimony, and certain unpaid educational loans and taxes, as well as liabilities for fraud. Congress evidently concluded that the creditors' interest in recovering full payment of debts in these categories outweighed the debtors' interest in a complete fresh start. We think it unlikely that Congress, in fashioning the standard of proof that governs the applicability of these provisions, would have favored the interest in giving perpetrators of fraud a fresh start over the interest in protecting victims of fraud.

498 U.S. at 287.

The same considerations counsel rejection of a reasonable reliance requirement under Section 523 (a)(2)(A). The burden facing a defrauded creditor is already substantial. The creditor must discover the fraud and affirmatively object to discharge in a timely fashion. See *Kelly* v. *Robinson*, 479 U.S. at 42 n.4. It is the creditor, moreover, who bears the burden of persuasion as to each element of Section 523(a)(2)(A) before the bankruptcy court. Bankr. R. 4005; see generally *Grogan* v. *Garner*, *supra*. Even where a creditor has reduced to judgment a state or federal fraud claim, it may still be required to relitigate that claim in bankruptcy court, to the extent that the elements of the underlying claim differ from the provisions of Section 523. See *Kelly* v. *Robinson*, 479 U.S. at 48 n.8. The Court should not increase a defrauded creditor's burden without a clear direction to do so from Congress.

D. Imposition Of A Reasonable Reliance Requirement On Creditors Proceeding Under Section 523 (a)(2)(A) Cannot Be Justified By Common Law Principles Of Fraud

Some of the courts that require proof of reasonable reliance have purported to rely on common law fraud principles. See, *e.g.*, *In re Hagedorn*, 25 B.R. 666, 669 (Bankr. S.D. Ohio 1982); *In re Paolino*, 89 B.R. 453, 462 (Bankr. E.D. Pa. 1988); see also *In re Kirsh*, 973 F.2d 1454, 1458-1459 (9th Cir. 1992) (finding reasonableness to be component of reliance inquiry); but see *In re Mayer*, 51 F.3d at 675-676 (rejecting reasonableness requirement based on, *inter alia*, common law tort principles). The reasoning of those decisions is flawed. The powerful textual and historical indicia of congressional purpose discussed above make the resort to state common law traditions inappropriate in this case. "[T]he issue of nondischargeability [is] a matter of federal law governed by the terms of the Bankruptcy Code." *Grogan* v. *Garner*, 498 U.S. at 284. See also *Astoria Fed. Savings & Loan Ass'n* v. *Solomino*, 501 U.S. 104, 110 (1991) (common law principles are to be "accorded sway only upon legislative default, applying where Congress has failed expressly or impliedly to evince any intention on the issue")

The common law principles of tort prevailing at the time of the Code's enactment, moreover, did not impose on victims of fraud the duty of investigation required of petitioners in this case (Pet. App. 30). See 3 Restatement (Second) of Torts § 540, at 88 (1977) ("The recipient of a fraudulent misrepresentation of fact is justified in relying on its truth, although he might have ascertained the falsity of the representation had he made an investigation."); William L. Prosser, *The Law of Torts* 718 (4th ed. 1971) (fraudulent assertions "may justifiably be relied on without investigation, not only where such an investi-

gation would be burdensome or difficult, * * * but likewise where the falsity of the representation might be discovered with little effort by means easily at hand"). Even under common law principles, therefore, the courts below placed too great a burden on creditors victimized by fraud.

CONCLUSION

The judgment of the court of appeals should be vacated and the case remanded for further proceedings consistent with this Court's decision.

Respectfully submitted.

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